

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 SPC-03 AID-20 EB-11 NSC-07 RSC-01

CIEP-02 TRSE-00 SS-20 STR-08 OMB-01 CEA-02 CIAE-00

DODE-00 PM-07 H-03 INR-10 L-03 NSAE-00 PA-04 PRS-01

USIA-15 COME-00 FRB-02 XMB-07 OPIC-12 LAB-06 SIL-01

DRC-01 /168 W

----- 116748

R 160030Z MAR 74

FM AMEMBASSY SAN JOSE

TO SECSTATE WASHDC 6511

INFO AMEMBASSY GUATEMALA

AMEMBASSY MANAGUA

AMEMBASSY PANAMA

AMEMBASSY SAN SALVADOR

AMEMBASSY TEGUCIGALPA

C O N F I D E N T I A L SECTION 1 OF 2 SAN JOSE 1046

GUATEMALA FOR ROCAP

E.O. 11652: GDS

TAGS: ECON, EFIN, CS, XK

SUBJECT: CONFIDENCE CRISIS

REF: (A) SAN JOSE 706

(B) SAN JOSE 1001

1. SUMMARY: EROSION OF BUSINESS CONFIDENCE NOTED
IN REFERENCE (A) SEEMS TO HAVE SLOWED, BUT THERE HAS BEEN
NO BASIC CHANGE IN UNDERLYING FACTORS: INFLATIONARY
PRESSURES CONTINUE WITH MORE INFLATION IMPLICIT IN
WAGE AND FAMILY SUBSIDY PLAN BILLS; NET RESERVES
CONTINUED TO DWINDLE THROUGH FEBRUARY. MANY BUSINESS-
MEN SEEM RESIGNED TO "LIVING WITH INFLATION", BUT
COSTA RICA'S POLITICAL DYNAMICS WHEREBY INTEREST
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GROUPS ATTEMPT TO PROTECT SELVES BY DRAGGING OUT, DEBATING

AND MODIFYING ADMINISTRATION INITIATIVES IS IN FULL PLAY.
IF ANYTHING, DEMORALIZATION IN THE ECONOMIC AREA OF
THE PUBLIC SECTOR IS WORSE. AMONG ECONOMISTS, A 1974
INFLATION "GUESTIMATE" OF 30 PERCENT IS GAINING POPULARITY.

END SUMMARY.

2. THIS CABLE IS AN UPDATE OF REFERENCE (A),
WHICH LOOKED AT THE ECONOMIC SCENE AND CONCLUDED
THAT THE PARTICULAR BUNDLE OF PROBLEMS FACING COSTA
RICA WAS HAVING A NEGATIVE EFFECT ON CONFIDENCE
AND COULD SNOWBALL INTO NEW BALANCE OF PAYMENTS
PROBLEMS. WHILE THE UNDERLYING FACTORS HAVE NOT
SUBSTANTIALLY CHANGED, THE CRISIS ATMOSPHERE THAT
SEEMED TO BE DEVELOPING TWO WEEKS AGO HAS ABATED.
IF NOTHING ELSE, THIS AGAIN DEMONSTRATES THE COSTA RICAN
GENIUS FOR DIFFUSING AND PUTTING OFF UNPLEASANTNESS,
OF LOBBYING TO CHANGE WHAT CAN BE CHANGED, AND THE
LEGENDARY "TICO SHORT ATTENTION SPAN". MAJOR
FACTORS ARE:

3. STATE OF RESERVES AND EXCHANGE RATE REUNIFICATION.
THE CENTRAL BANK BOARD STILL HAS NOT COME TO AGREE-
MENT ON THE TEXT OF A PROPOSED EXCHANGE REUNIFICATION
(DEVALUATION) LAW; HOWEVER, ONE PROBLEM HAS
BEEN REMOVED WITH THE AGREEMENT BY OTHER CACM
RBCOUNTRIES TO EXTEND THE CACM AGREEMENT OF OCTOBER
19, 1972, BY 90 DAYS. DELAY ON REUNIFICATION--ALONG WITH
INCREASED IMPORT COSTS--CONTINUED TO HAVE AN IMPORTANT
IMPACT ON RESERVES. NET LOSS THROUGH FEBRUARY WAS
\$9.4 MILLION TO A BALANCE OF \$51.4 MILLION (PROVISIONAL
FIGURE). DETERIORATION IN THE OFFICIAL (COLONES 6.68)
MARKET HAS BEEN RAPID--AMOUNTING TO ABOUT \$14 MILLION--
HOWEVER, LARGE SUMS WERE TRANSFERRED (AT A LOSS TO
THE CENTRAL BANK) FROM THE HIGHER FREE MARKET
(COLONES 8.60) TO MEET OFFICIAL MARKET OBLIGATIONS, SO
A DECLINE IS SHOWN IN BOTH OFFICIAL AND FREE MARKET
RESERVES. A THIRD CATEGORY OF RESERVES USED IN
CALCULATING COSTA RICA'S NET RESERVE POSITION--
DOLLARS IN HANDS OF INDIVIDUALS (MOSTLY DOLLAR CHECKING
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ACCOUNTS NOT UNDER THE CENTRAL BANK'S CONTROL)--
INCREASED ABOUT \$4.2 MILLION FOR A FEBRUARY 28 BALANCE
OF ABOUT \$20 MILLION. THIS SUGGESTS THAT SOME
INDIVIDUALS HAVE BEEN ABLE TO GET AROUND CENTRAL BANK
REGULATIONS AND EXERCISE CLAIMS AGAINST OFFICIAL
RESERVES, ONLY TO PLACE DOLLARS SO PURCHASED
IN THEIR PERSONAL DOLLAR ACCOUNTS AS A HEDGE AGAINST
DEVALUATION. (SENSITIVE DATA)

4. CENTRAL BANK DEFENSIVE MEASURES APPEAR TO HAVE SLOWED RESERVE DETERIORATION IN THE LST SEVERAL DAYS. THESE MEASURES INCLUDE: (1) SUSPENSION OF ARTICLE 64--THIS HAD THE EFFECT OF SHIFTING ADDITIONAL IMPORTS INTO THE FREE MARKET (SEE REFERENCE B) AND (2) EXCHANGE RATIONING FOR OFFICIAL RATE (OR REGISTERED) CAPITAL TRANSFERS--I.E., ALLOWING THE PRESA TO BUILD UP FOR SUCH TRANSACTIONS. RE. (2) AS OF DECEMBER 31 APPROXIMATELY \$22 MILLION IN REGISTERED CAPITAL WAS LISTED BY THE BANK AS DUE AND PAST DUE PERSONAL FOREIGN OBLIGATIONS AND THUS ELIGIBLE FOR OFFICIAL RATE DOLLARS. ANOTHER \$79 MILLION ON THE BOOKS HAD NOT REACHED MATURITY. SINCE THE BANK IS OBLIGATED TO PROVIDE DOLLARS AGAINST REGISTERED CAPITAL AT THE OFFICIAL RATE IN EFFECT AT THE DATE OF THE EXCHANGE TRANSACTION, ANYONE WHO HAS NOT PURCHASED DOLLARS BY THE DATE OF REUNIFICATION PRESUMABLY STANDS TO SUSTAIN A LOSS OF ABOUT 30 PERCENT. (SENSITIVE DATA)

5. OBLIGATIONS CONTRACTED UNDER OLD ARTICLE 64, HOWEVER, (E.G. AN EXIMBANK CREDIT FOR IMPORT OF CAPITAL GOODS) ARE NOT AFFECTED. REPORTEDLY, EXCHANGE IS BEING MADE AVAILABLE TO MEET SCHEDULED PAYMENTS FOR SUCH OBLIGATIONS. MOREOVER, THE BANK INTENDS TO MAKE EXCHANGE AVAILABLE FOR ARTICLE 64 PAYMENTS AT THE COLONES 6.68 RATE EVEN AFTER DEVALUATION.

6. ANOTHER FACTOR AFFECTING RESERVES SHOWS UP ON THE EXPORT SIDE. EXPORTERS ARE DELAYING EXCHANGE SURRENDERS AS LONG AS POSSIBLE IN HOPE OF REAPING A DEVLUTION WINDFALL. ALSO ILLEGAL EXCHANGE
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RETENTIONS VIA SUCH MECHANISMS AS UNDER-INVOICING ARE WIDESPREAD.

7. CENTRAL BANK REFORM. THIS MEASURE HAS NOW BEEN REPORTED OUT OF COMMITTEE IN AMENDED FORM AND SEEMS REASONABLY SURE OF EARLY PASSAGE. TIGHT EXECUTIVE CONTROL SUGGESTED IN THE ORIGINAL MEASURE HAS BEEN WATERED DOWN SOMEWHAT, BUT THIS BILL IS FAR FROM IDEAL AND A WEAKENED CENTRAL BANK SEEMS IN PROSPECT.

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C O N F I D E N T I A L SECTION 2 OF 2 SAN JOSE 1046

8. WAGE AND PAYROLL PRESSURES. CONSIDERABLE
UNCERTAINTY EXISTS ABOUT JUST HOW MUCH PAYROLLS
WILL BE AFFECTED BY INCREASES IN MINIMUM WAGES AND
THE PROPOSED FAMILY ASSISTANCE PLAN (ASIGNACION
FAMILIAR). PRESIDENT FIGUERES FANNED FIRES BY
SUGGESTING THAT A 52 PERCENT INCREASE IN THE BASIC
MINIMUM WOULD SHORTLY BE PROMULGATED, WITH LESSER
INCREASES FOR OTHER CATEGORIES. THE NATIONAL SALARY
COUNCIL, HOWEVER, TOOK EXCEPTION, NOTING THAT IT WOULD
NEED 30 DAYS TO STUDY INFLATIONARY CONDITIONS BEFORE
SETTING A NEW WAGE SCHEDULE (IN MOST INDUSTRIES,
THE MINIMUM SCHEDULE DETERMINES PREVAILING WAGES),
THUS ALLAYING FEARS SOMEWHAT. HOPE THAT THE
ASIGNACION FAMILIAR MEASURE WOULD BE POSTPONED WAS
SHORTLIVED. THE PROJECT HAS NOW BEEN PRESENTED TO
THE ASSEMBLY -- THIS MIGHT MEAN A PAYROLL TAX OF
UP TO 15 PERCENT.

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9. OUTLOOK. THERE HAS BEEN NO BASIC CHANGE IN THE SITUATION FORESEEN IN PARAGRAPHS 5 AND 6 OF REFERENCE (A). WHILE THE BUSINESS COMMUNITY NOW ON BALANCE MAY BE TAKING A "WAIT AND SEE" ATTITUDE, DEMORALIZATION IN THE ECONOMIC AREA OF THE PUBLIC SECTOR, IF ANYTHING, IS MORE PRONOUNCED. MOREOVER, THERE IS GROWING APPREHENSION AMONG THE CADRE OF PLN "QUASI-OFFICIALS", THOSE YOUNGER PLN ECONOMISTS ON THE FRINGES OF GOVERNMENT WHO SERVE AS ADVISERS AND WHO MOVED IN AND OUT OF THE FIGUERES ADMINISTRATION IN VARIOUS CAPACITIES. THIS GROUP, WHICH SOME TIME AGO BECAME DISENCHANTED WITH FIGUERES AND WHICH WORKED HARD ON THE PLN ECONOMIC PROGRAM, FEELS THAT IT HAS NOT YET BEEN BROUGHT INTO THE INNER-CIRCLE OF ODUBER ADVISERS AS IT EXPECTED--AT A TIME WHEN PERHAPS THE MOST IMPORTANT ECONOMIC DECISIONS FOR THE NEXT FOUR YEARS ARE BEING MADE (BY INTENT OR DEFAULT). AMONG THIS GROUP AND OTHER "OPPOSITION" ECONOMISTS PREDICTIONS OF A 1974 INFLATION RATE OF 30 PERCENT ARE ASSUMING THE STATUS OF CONVENTIONAL WISDOM "GUESTIMATE".
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